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| Date: | **02/20/14** | Bill No: | **Senate Bill 1203** |
| Tax Program: | **Property** | Author: | **Jackson** |
| Sponsor: | **BOE Chairman Horton** | Code Section: | **RTC Section 214** |
| Related Bills: | | Effective Date: | **01/01/15** |

## BILL SUMMARY

This bill retroactively provides that a payment in lieu of taxes agreement (PILOT), as specified, does not make a low-income housing project ineligible for the property tax welfare exemption. Voids all PILOT agreements except those with fees that are (1) consistent with other residential development fees; or (2) for services that do not exceed actual costs, including services tied to bond issuance and project monitoring.

## ANALYSIS

### CURRENT LAW

**PILOT Agreements**. Existing property tax law is silent on the issue of PILOT agreements related to low-income housing projects.[1]

**Property Tax Exemption.** The law provides that the welfare exemption applies to certain low-income housing properties. One exemption requirement is that the property owner must be able to certify the following:

- That an enforceable and verifiable agreement exists restricting the development to appropriate lower income household usage and rents.
- That the property tax savings from the exemption are used to maintain the affordability of, or reduce rents otherwise necessary for, the units occupied by lower income households.

The question has been raised whether a property owner can properly make the property tax certification when a PILOT agreement exists with local government. The BOE issued a non-binding legal opinion that a property owner can make the required certification in good faith if rents actually meet or are lower than the restrictions set forth in the enforceable agreement, and if the property owner has a reasonable belief that its PILOT payment will go directly to support or benefit the low-income household units.

### PROPOSED LAW

**PILOT Agreements.** This bill provides that any PILOT agreement, as defined, is void. “Payment in lieu of taxes agreement” means an agreement between a local government and a property owner of a low-income housing project that requires the owner to pay the local government a “charge.”

[1] RTC §237(b) addresses payments that an Indian tribe may make related to a low-income housing project owned and operated by the tribe.

A charge does not include:

- Impact fees consistent with fees paid by all other residential developments.
- Fees for a specific service, including bond issuance and project monitoring, provided directly to the low-income housing project that does not exceed the actual cost to provide the service. The services provided must not be provided to other properties not charged.

**Property Tax Exemption.** This bill provides that a PILOT agreement between a low-income housing project and a local government, as defined, does not make the project ineligible for the welfare exemption.

**Retroactive.** Its provisions are declaratory of existing law making the measure retroactive to any pre-existing PILOT agreement.

## IN GENERAL

Under authority granted by the California Constitution, the Legislature has chosen to exempt from property taxation property used exclusively for religious, hospital, or charitable purposes. The exemption's main provisions, known as the "welfare exemption," are set forth in RTC Section 214(a), which enumerates many eligibility requirements.

In addition to the RTC Section 214(a) requirements, low-income housing projects must meet criteria set forth in RTC Section 214(g). Specifically, under RTC Section 214(g)(2)(B), the low-income housing property owner must certify that:

> [T]he funds that would have been necessary to pay property taxes are used to maintain the affordability of, or reduce rents otherwise necessary for, the units occupied by lower income individuals.

When claimants cannot make this certification, they may not receive a welfare exemption.

## BACKGROUND

Recently the Ventura County Assessor's Office sent notification of possible welfare exemption revocation to five nonprofit housing developments that have PILOTs with various cities. The assessor took this action after the office received a courtesy copy of a December 23, 2011 BOE legal opinion letter (never annotated). The legal opinion concluded that the required RTC Section 214(g)(2)(B) certification could not be made with respect to two projects in Ventura County due to a PILOT agreement calling for in-lieu payments to the local government. Thereafter, the assessor's office investigated other low-income housing projects with PILOTs, and a statewide discussion commenced to reexamine this issue.

**BOE Legal Memo.** On March 20, 2013, the BOE's Legal Department issued a memo reviewing the December 14, 2011 letter and an earlier annotated letter dated September 29, 2003, (former Property Tax Annotation 880.0155).

**BOE Town Hall Meeting.** On November 6, 2013, the BOE held a panel discussion and some attendees noted the need to pursue legislative action. A video of the town hall meeting is available online.

**BOE Publishes New Annotation.** On November 19, 2013, the BOE Members took action to publish a new Annotation 880.0155.005 based on the memo and deleted the prior annotated letter.

Property Tax Annotation 880.0155.005 now states:

> RTC §214(g)(2)(B) requires a developer to certify that property tax savings be used to "maintain the affordability of" or "reduce rents otherwise necessary for" low-income housing units. A Payment In Lieu of Tax (PILOT) Agreement between a local government and an owner of a low-income housing project does not disqualify a developer from making the certification if rents have been maintained in accord with those required by section 214(g)(2)(A), and the developer has a reasonable belief that the PILOT payment will be used to support or benefit the low-income housing development.

**Assembly Joint Informational Hearing.** On February 3, 2014, the Assembly Committees on Housing and Community Development, Local Government, and Revenue and Taxation held a hearing entitled "Understanding the Scope of Payment in Lieu of Taxes (PILOTs) and Their Impact on the Welfare Property Tax Exemption" A video of the hearing and agenda is available online via the Cal Channel website.

**Legislative Analyst's Office Report.** The LAO issued a report for this hearing entitled "Nonprofits and the Property Tax."

**COMMENTS**

1. **Sponsor and Purpose.** BOE Chairman Jerome Horton is sponsoring this measure to address this emerging property tax issue in statute. According to the author's office, the intent of this bill is to prohibit escape assessments from being levied on projects that had PILOT agreements. For those projects that have already received escape assessments, the intent is that the *outstanding* taxes related to those escape assessments be cancelled. The intent with respect to refunds is that taxes already paid would not be refunded.[2]

2. **PILOT issue simplified.** Low-income housing property may be exempt from property taxation under the Welfare Exemption. Since the local government will not receive its portion of property tax if the property is exempt, low-income housing developers or owners sometimes enter into agreements (often called PILOT agreements) to compensate local government for costs associated with the property. For property tax purposes, some concern exists regarding the effect of a PILOT on a low-income housing property's eligibility for the Welfare Exemption.

3. **This bill provides legislative guidance that may reduce uncertainty regarding this issue.** The BOE, assessors, local governments, nonprofit organizations, and project financers have an interest in clear and consistent treatment of properties subject to PILOT agreements when Welfare Exemption eligibility is at stake. This bill specifies the requirements that payment agreements between a local government and a property owner must meet to avoid jeopardizing a low-income housing property's Welfare Exemption.

[2] As noted below, explicit language to this effect should be added.

4. **Financial implications of retroactive property tax exemption revocation.** The low-income housing project owners are very concerned about the prospect of losing the welfare exemption for prior years in which they made PILOT payments Since they did not anticipate such liabilities, they have insufficient funds to pay back taxes and associated penalties.

5. **This bill would benefit from clarification consistent with its purpose.** To leave no doubt that low-income projects that have historically received the exemption in this state continue to be eligible, and to cancel outstanding property taxes on those projects where the exemption has been revoked and escape assessments issued due to a PILOT agreement, express language so stating would be helpful. For example, see RTC Section 62.1 and RTC Section 214.16.

   (C) This paragraph is declaratory of existing law and shall apply to any PILOT agreement entered into prior to its enactment. <u>Any outstanding ad valorem tax, interest, or penalty that was levied between January 1, 2012, and January 1, 2015, as a result of a PILOT agreement shall be canceled. However, there shall be no refund of tax, interest, or penalty, as so levied, that was paid prior to January 1, 2015.</u>

6. **Property tax savings use requirement.** This bill states that a pilot payment agreement does not make a project *in*eligible for the welfare exemption. In its present form, this bill does not expressly address or amend the provision of law that requires property tax savings to be used to maintain the affordability of, or reduce rents otherwise necessary for, the units occupied by lower income households. Additionally, the bill does not expressly allow the associated savings to be used to support or improve a project to the general benefit of its lower income tenants. It would be extremely difficult and costly for either the assessor or the project to annually attempt a dollar-for-dollar tracking of property tax savings to determine whether such savings were used to "maintain affordability." Additional clarifying amendments consistent with the author's intent on this issue would be helpful to property tax administrators.

**COST ESTIMATE**

The BOE and counties co-administer the welfare exemption. The BOE would incur some minor absorbable costs to inform and advise county assessors, the public, and staff of the law changes and address ongoing implementation issues and questions. These costs are estimated to be under $10,000.

**REVENUE ESTIMATE**

Information on the number of PILOT agreements has proven difficult to obtain and is unknown, making it impossible to assess the full fiscal impact of this proposal. To date, the identified property tax revenues at stake relate to four low-income housing projects that have received escape assessments for prior years' taxes related to PILOT agreements. Two projects have entered into five-year payment plans and have paid a total of $450,000 toward outstanding liabilities of over $6.1 million. In other projects where PILOT agreements became an issue, the city dropped the PILOT payment requirement to ensure the project would remain eligible for the property tax exemption. Thus, those properties do not impact this revenue estimate.

Exemption eligibility status is uncertain regarding projects located in California, pending the outcome of this issue. The intent of this bill is to maintain eligibility for all other projects currently receiving the exemption, regardless of whether they have entered into a PILOT agreement. According to the author's office, the intent of this bill is to require the cancellation of outstanding taxes related to escape assessments for prior years' taxes. But, those property taxes already collected ($450,000) would not be subject to refund.



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